LETTER OPINION
98-L-178

October 15, 1998

Mr. Sparb Collins
Executive Director
North Dakota Public Employees
Retirement System
PO Box 1214
Bismarck, ND 58502

Dear Mr. Collins:

Thank you for your letter requesting my opinion on the North Dakota Public Employees Retirement System (PERS) Board's options under state law in view of imminent federal tax law changes to the deferred compensation program administered by the Board. You indicate that PERS is currently in the process of bringing its deferred compensation plan into compliance with new tax law provisions which take effect January 1, 1999. You state that PERS has been revising and updating its contracts with its current investment providers to comply with the new federal requirements and to update other necessary administrative provisions. You further state that all but four of the current investment providers have signed the new agreements.

You indicate that the Board has been advising plan participants who have investments with the nonqualifying providers of the changes necessary and, presumably, that they must cease contributions to those nonqualifying providers. Your letter then outlines the Board's concerns about its options under state law if the participants do not willingly stop their contributions or transfer their accounts.

You first ask whether the Board has the authority under state law to stop an employee's contribution to a nonqualified account. N.D.C.C. § 54-52.2-03 provides that the administration of the deferred compensation program for state entities is under the direction of the PERS Board. Political subdivisions are also authorized to appoint the PERS Board to administer the program on their behalf. Id. The statute further provides:

> The public employees retirement board shall administer the deferred compensation program based on a plan in compliance with the appropriate provisions of the Internal Revenue Code and regulations adopted under those provisions. Not later than January 1, 1999, all plan assets and income must be held in trust, custodial

> accounts, or contracts as described in section 401(f) of the Internal Revenue Code [26 U.S.C. 401(f)] for the exclusive benefit of participants and their beneficiaries as required by section 457 of the Internal Revenue Code [26 U.S.C. 457]. Once the trust, custodial account, or contract is established as required by this section, the board shall act as fiduciary of the plan to the extent required by section 457 of the Internal Revenue Code [26 U.S.C. 457] and the board is authorized to do all things necessary for the proper administration of the plan to ensure that the plan maintains its qualified status.

N.D.C.C. § 54-52.2-03 (emphasis added).

The last two sentences in N.D.C.C. § 54-52.2-03 were added by the 1997 Legislature to track changes in federal tax law concerning public deferred compensation programs. See 1997 N.D. Sess. Laws ch. 464, § 7. Under prior federal law, until deferrals were made available to employees, "all property and rights purchased with such amounts, and all income attributable to such amounts, property, or rights . . . remain[ed] solely the property and rights of the employer, subject only to the claims of the employer's general creditors." 1996 United States Code Congressional and Administrative News 1474, 1559 (legislative history of P.L. 104-188). The reason for amending the law was that Congress found "it appropriate to require that benefits under a section 457 plan of a State and local government should be held in a trust (or custodial account or annuity contract) to insulate the retirement benefits of employees from the claims of the employer's creditors." Id.

26 U.S.C. § 457(g) now provides that "[a] plan maintained by an eligible employer described in subsection (e)(1)(A) shall not be treated as an eligible deferred compensation plan unless all assets and income of the plan described in subsection (b)(6) are held in trust for the exclusive benefit of participants and their beneficiaries." Under 26 U.S.C. § 401(f), certain custodial accounts, annuity contracts, and other contracts are treated as qualified trusts under certain circumstances, and the persons holding the assets of such accounts or contracts are treated as trustees.

As you indicated, because of the federal law changes, you have met with affected employees about the changes (and presumably the need to stop contributions to the nonqualifying providers). The question you raise concerns the authority of the Board to stop the contributions to the nonqualifying provider if an employee does not willingly agree to do so. The primary purpose of statutory construction is to

determine the intent of the Legislature, which must be initially sought from the language of the statute. Kim-Go v. J.P. Furlong Enterprises, Inc., 460 N.W.2d 694, 696 (N.D. 1990); County of Stutsman v. State Historical Society, 371 N.W.2d 321, 325 (N.D. 1985). Words in a statute are to be understood in their ordinary sense unless a contrary intention plainly appears, but any words explained in the North Dakota Century Code are to be understood as explained. N.D.C.C. § 1-02-02.

As noted above, N.D.C.C. § 54-52.2-03 provides, in conformity with federal law, that not later than January 1, 1999, all plan assets and income must be held in qualifying trusts, custodial accounts, or contracts as described in federal tax law. Future contributions may, thus, not be held in a nonqualifying trust, custodial account, or contract. Consequently, it is my opinion that if an employee fails to stop the contribution to a nonqualifying provider, the PERS Board as administrator and fiduciary of the plan has the authority to do so to ensure that the requirements of N.D.C.C. § 54-52.2-03 are followed. See N.D.C.C. § 1-02-38(4) (in enacting a statute, a result feasible of execution is intended).

This is consistent with the administrative rules pertaining to the deferred compensation program. N.D. Admin. Code § 71-04-01-01(9) defines "provider" as "any insurance company, federally insured financial institutions, Bank of North Dakota, or registered dealer under North Dakota Century Code chapter 10-04 authorized by the retirement board to provide investment vehicles to employees." (Emphasis added.) N.D. Admin. Code § 71-04-05-04 states that an "employer shall authorize payroll deductions in the deferred compensation plan only for providers authorized by the retirement board." (Emphasis added.) Accordingly, an employee may only choose, and an employer may only deduct money to be contributed to, an authorized provider. If a provider is no longer authorized, payroll deductions and contributions must cease.

You then ask whether the Board has the authority to transfer an account from a nonqualified provider to a qualified provider if the employee fails to do so. This question is more problematic. One of the essential elements of the deferred compensation plan has been the ability of the employee to choose both the qualified provider and the type of qualified investment vehicle to be utilized for investment of the deferred funds. For example, N.D.C.C. § 54-52.2-01 provides:

> The deferred compensation program may consist of a contract, purchase, or investment in a fixed or variable life insurance or annuity contract from any life

> underwriter duly licensed by this state who represents an insurance company licensed to contract business in this state, a savings account at a federally insured financial institution or the Bank of North Dakota, an account with or managed by a dealer registered under chapter 10-04, or any combination of contracts or accounts authorized by this section, as specified by the employee.

(Emphasis added.) N.D.C.C. § 54-52.2-05 provides that deferred compensation program administrators are "hereby authorized to make payments or investments under the deferred compensation program as specified by the employee . . . ." (Emphasis added.) There have historically been a number of qualified providers from which an employee could choose. If an employee fails to make a choice among the current list of qualified providers, the questions arise whether the Board may select a provider to whom it may transfer the account; and, if so, how the Board would make the selection the employee would otherwise have made.

As noted above, state law now requires that by January 1, 1999, all plan assets and income must be held in qualifying trust, custodial accounts, or contracts. N.D.C.C. § 54-52.2-03. Further, the Board is authorized to do all things necessary for the proper administration of the plan to ensure that the plan maintains its qualified status, and the Board is authorized to do all things necessary to preserve the tax-exempt status of the plan. N.D.C.C. §§ 54-52.2-03 and 54-52.2-03.2(2). Thus, while a plain reading of the requirements of N.D.C.C. ch. 54-52.2 reveals that the Board has the authority to ensure that the plan remains qualified and preserves its tax-exempt status, there is no explicit direction or guidance in the chapter detailing how the Board is to act if the employee fails to designate a new qualified provider.

Federal law provides that unless the deferred compensation and any income therefrom are placed in qualifying trusts, custodial accounts, or contracts, such property remains the sole property and rights of the employer subject only to the claims of the employer's general creditors. 26 U.S.C. § 457(b)(6). N.D.C.C. § 21-04-02 provides that public funds belonging to or in the custody of the state must be deposited in the Bank of North Dakota. N.D.C.C. § 21-04-03 provides that public funds belonging to or in the custody of political subdivisions must also be deposited in the Bank of North Dakota or other financial depository. Public funds are broadly defined in N.D.C.C. § 21-04-01(5) as including:

> [A]ll funds derived from taxation, fees, penalties, sale of bonds, or from any other source which belong to and are the property of a public corporation or of the state . . . and all funds from whatever source derived and for whatever purpose to be expended of which a public corporation or the state have legal custody. The term includes funds of which any board, bureau, commission, or individual, created or authorized by law, is authorized to have control as the legal custodian for any purpose whatsoever whether such funds were derived from general or special taxation or the assessment of persons or corporations for a specific purpose.

(Emphasis added.)

Additionally, the Bank of North Dakota is an authorized provider under N.D.C.C. § 54-52.2-01 and has signed an agreement to provide deferred compensation services. Under federal law, certain custodial accounts may be held by certain banks that may qualify as a provider. See 26 U.S.C. § 401(f). Although state deferred compensation funds not held in a qualifying trust, custodial account, or contract legally belong to the state as the employer, absent this special circumstance such funds would not come under the purview of the general depository provisions of N.D.C.C. ch. 21-04 since they would be subject to the more specific provisions of N.D.C.C. ch. 54-52.2. See N.D.C.C. § 1-02-07. Nevertheless, since federal and state law preclude holding these nonqualifying funds in a qualifying plan after January 1, 1999, N.D.C.C. ch. 21-04 does supply a way to effect their transfer. Consequently, it is my opinion that the Board would have the authority under N.D.C.C. chs. 54-52.2 and 21-04 to transfer an account balance from a nonqualified provider to the Bank of North Dakota in order to meet the January 1, 1999, deadline. However, no new deferrals could be added to the transferred account in the Bank of North Dakota without the agreement of the employee.

Even though I have concluded that the Board has the authority to stop deferrals to nonqualified accounts and transfer accounts from nonqualified providers to the Bank of North Dakota, this is obviously not the preferred course of action. As I pointed out, the law grants the employee the right to specify whether the employee will have income deferred, and which qualified providers and investment vehicle will be selected. All reasonable efforts should be exhausted by the Board to come to an agreement with the affected employees.

Sincerely,

Heidi Heitkamp
ATTORNEY GENERAL

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